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**UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK**

UNITED STATES OF AMERICA *ex rel.*  
SHERRY A. HUNT,

Plaintiff,

-against-

CITIGROUP, INC.,  
CITIBANK NA, INC., and  
CITIMORTGAGE, INC.,

Defendants.

11 Civ. 05473 (VM)

**COMPLAINT-IN-INTERVENTION  
OF THE UNITED STATES OF  
AMERICA**

**Jury Trial Demanded**

UNITED STATES OF AMERICA,

Plaintiff-Intervenor,

-against-

CITIMORTGAGE, INC.,

Defendant.

The United States of America (the “United States” or the “Government”), by its attorney, Preet Bharara, United States Attorney for the Southern District of New York, having filed a notice of intervention pursuant to 31 U.S.C. § 3730(b)(4), brings this complaint-in-intervention against CitiMortgage, Inc. (“CitiMortgage” or “Citi”), alleging as follows:

### **INTRODUCTION**

1. This is a civil fraud action by the United States to recover treble damages and civil penalties under the False Claims Act, as amended, 31 U.S.C. §§ 3729 *et seq.*, civil penalties under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”), 12 U.S.C. § 1833a, and common-law damages arising from fraud on the United States Department of Housing and Urban Development (“HUD”) in connection with Citi’s residential mortgage lending business. As set forth more fully below, Citi has profited for years from its position as a large HUD-approved residential mortgage lender while submitting false statements to HUD about its underwriting and its quality control. At the same time, Citi failed to implement even the most basic quality control measures that are required by HUD to stop the reckless lending that Citi engaged in. Among other things, Citi failed to conduct the required full review of all early payment defaults (*i.e.*, loans defaulting in the first six months), failed to report to HUD findings of fraud and other serious deficiencies in its loans, and encouraged its business employees to manipulate the reports of its quality control department to conceal the number and severity of deficiencies in Citi’s loans. Not only has Citi’s misconduct cost the United States millions of dollars in insurance claims, with additional losses expected in the future, but also it has led to mortgage defaults and home evictions and foreclosures across the country.

2. HUD, through its Federal Housing Administration (“FHA”), insures lenders against losses to homebuyers. FHA insures approximately one third of all new residential mortgages in

the United States and is the largest mortgage insurer in the world. Under HUD's mortgage insurance program, if a homeowner defaults on a loan and the mortgage holder forecloses on the property, HUD will pay the mortgage holder the balance of the loan and assume ownership and possession of the property. HUD incurs expenses in managing and marketing the foreclosed-upon property until it is resold.

3. By protecting lenders against defaults on mortgages, FHA mortgage insurance encourages lenders to make loans to millions of creditworthy Americans who might not otherwise satisfy conventional underwriting criteria. FHA mortgage insurance also makes mortgage loans valuable in the secondary markets, as FHA loans are secured by the full faith and credit of the United States.

4. The continued availability of FHA mortgage insurance, however, depends on HUD's ability to accurately assess the risk of default on the loans it insures. To accomplish this task, HUD promulgated extensive guidelines and regulations to ensure that only creditworthy borrowers are being insured, and HUD relies on certifications by lenders that the loans they submit for insurance comply with HUD standards and guidelines specifically designed to mitigate the risk to HUD. HUD also relies on certifications by lenders that they themselves are following HUD requirements by operating a quality control program that (among other things) reviews suspicious early loan defaults and reports to HUD any loan endorsed for FHA mortgage insurance that is later found to contain fraud or other serious deficiencies.

5. Citi has been an approved FHA direct endorsement lender since 1981. As a direct endorsement lender, Citi acts as a fiduciary of HUD, underwriting and endorsing mortgages as qualified for FHA insurance. HUD requires a direct endorsement lender such as Citi to certify

each year that Citi complies with necessary HUD and FHA requirements, including those requiring implementation of a quality control program meeting HUD standards. Further, HUD requires a lender such as Citi, for each mortgage endorsed, to certify that the lender has conducted due diligence and that the mortgage is eligible for FHA insurance. HUD, which does not perform any pre-endorsement review of the loan, relies on these certifications.

6. Since 2004, Citi has endorsed nearly 30,000 mortgages for FHA insurance, totaling more than \$4.8 billion in underlying principal obligations. Of those loans, 9,636 (or more than 30% percent) have defaulted. Citi's default rate soared to more than 47% for loans originated in 2006 and 2007. In other words, nearly every other loan Citi endorsed for FHA insurance in the critical years leading up to the financial crisis defaulted, resulting in foreclosures and evictions and ultimately depressed real estate values, all to the detriment of the national housing market and the national economy. Moreover, of the loans Citi originated in 2007, over 10.5% went into early payment default. HUD has already paid nearly \$200 million in insurance claims on loans that Citi originated or underwrote since 2004. A substantial percentage of those claims resulted from loans that were ineligible for FHA insurance and never should have been insured. Thousands of other loans are currently in default, which the Government expects to result in additional insurance claims paid by HUD in the future.

7. While Citi made substantial profits through the sale and/or securitization of FHA-insured mortgages, it wrongfully endorsed mortgages that were not eligible for FHA insurance under HUD rules. Notwithstanding the mortgages' ineligibility, Citi endorsed the mortgages for FHA insurance by falsely certifying that they complied with HUD requirements and that its underwriters had conducted any necessary due diligence required by HUD rules. By endorsing

ineligible mortgages and falsely certifying compliance with HUD rules, Citi wrongfully obtained FHA insurance for these mortgages.

8. Citi also failed to implement the quality control measures designed to protect HUD and the public from reckless lending. For instance, although HUD required Citi to conduct a full review of every loan that went into early payment default, for years Citi did such a review on only approximately half of its EPDs, giving the remainder nothing more than a cursory review. Further, even when Citi's quality control department did conduct the required reviews of loans, its findings were not used, as HUD requires, to improve underwriting standards and loan quality. Instead, Citi's quality control reports became—and remain—a battleground within Citi, with those in Citi's business production units applying what they describe as “brute force” to pressure Citi's quality control managers to downgrade their findings. Indeed, Citi's own director of quality control described the business personnel's conduct as “nothing short of abuse and bordering on fraudulent actions.” As a result, Citi's quality control program lacks the basic independence from business unit control that is required by HUD.

9. Citi also prevented its quality control department from reporting to HUD when it found fraud or other material violations in mortgage loans previously endorsed for HUD insurance. A lender is required to report such findings to HUD within sixty days of discovery so that the violations—and especially patterns of violations—can be identified and corrected and losses minimized. Citi, however, has essentially failed to maintain a self-reporting system. From 2005 to 2010, Citi failed to report even a *single loan* that it had originated or underwritten itself. Instead, in the rare cases where Citi did actually self-report a loan, the loan was always one that Citi had purchased from another lender. The loans that Citi failed to report to HUD

include ones in which Citi had even confirmed fraud in the form of fabricated bank statements and other misrepresentations. Citi's failure to self-report prevented HUD from auditing and scrutinizing the practices that allowed Citi to underwrite fraudulent and other deficient loans in the first place.

10. The United States seeks the maximum amount of damages and the maximum amount of civil penalties allowed by law. Specifically, the United States seeks treble damages under the False Claims Act and compensatory damages under the common law for breach of fiduciary duty for each of Citi's defaulted loans that was ineligible for FHA insurance. The United States also seeks to recover civil penalties under FIRREA.

### **JURISDICTION AND VENUE**

11. This Court has jurisdiction pursuant to 31 U.S.C. § 3730(a) and 28 U.S.C. §§ 1331.

12. Venue is proper in this judicial district pursuant to 31 U.S.C. § 3732(a) and 28 U.S.C. §§ 1391(b)(1), (b)(3), and (c) because the defendant can be found and transacts business in this judicial district.

### **PARTIES**

13. Plaintiff is the United States of America.

14. Relator Sherry A. Hunt ("Hunt") is an individual domiciled in Missouri and a current employee of CitiMortgage.

15. Defendant CitiMortgage is a New York corporation with its principal place of business located in O'Fallon, Missouri.

## **CIVIL STATUTES TO COMBAT MORTGAGE FRAUD**

16. The False Claims Act provides liability for any person (i) who “knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval”; or (ii) who “knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim.” 31 U.S.C. § 3729(a)(1)(A)-(B). The False Claims Act further provides that any person who violates the Act: “is liable to the United States Government for a civil penalty of not less than [\$5,500] and not more than [\$11,000] . . . , plus 3 times the amount of damages which the Government sustains because of the act of that person . . .” 31 U.S.C. § 3729(a); *see* 28 C.F.R. § 85.3(a)(9).

17. Congress enacted FIRREA in 1989 to reform the federal banking system. Toward that end, FIRREA authorizes civil enforcement of enumerated criminal predicate offenses—as established by a preponderance of the evidence—that affect financial institutions and certain government agencies. *See* 12 U.S.C. § 1833a(e). Two of the predicate offenses that can form the basis of liability under FIRREA are relevant here: First, 18 U.S.C. § 1006 prohibits any person, who is “connected in any capacity with [HUD],” from “mak[ing] any false entry in any book, report or statement of or to [HUD]” with the “intent to defraud [HUD] . . . or any other body politic . . . or to . . . deceive any officer, auditor, examiner, or agent of [HUD] or of [a] department or agency of the United States.” Second, 18 U.S.C. § 1014 prohibits any person from “knowingly mak[ing] any false statement or report, or willingly overvalue any land, property, or security, for the purpose of influencing in any way the action of [FHA].” *Id.*

18. FIRREA provides that the United States may recover civil penalties of up to \$1 million per violation, or, for a continuing violation, up to \$1 million per day or \$5 million,

whichever is less. 12 U.S.C. § 1833a(b)(1)-(2). The statute further provides that the penalty can exceed these limits to permit the United States to recover the amount of any gain to the person committing the violation, or the amount of the loss to a person other than the violator stemming from such conduct, up to the amount of the gain or loss. 18 U.S.C. § 1833a(b)(3).

## **FACTUAL BACKGROUND**

### **A. The FHA Mortgage Insurance Program**

19. Pursuant to the National Housing Act of 1934, the FHA offers various mortgage insurance programs. Through these programs, FHA insures approved lenders (“mortgagees”) against losses on mortgage loans made to buyers of single-family housing. The program helps low-income and moderate-income families become homeowners by lowering some of the costs of their mortgage loans. FHA mortgage insurance encourages lenders to make loans to creditworthy borrowers who nevertheless might not meet conventional underwriting requirements.

20. In the event that a borrower defaults on an FHA-insured mortgage, the lender or other party holding the mortgage submits a claim to HUD for the costs associated with the defaulted mortgage and the sale of the property. HUD then pays off the balance of the mortgage and other related costs, and may assume ownership of the property. In the mortgage industry, HUD-insured loans are highly marketable for securitization and/or resale to investors both because such loans are expected to have met HUD requirements and because they are backed by the full faith and credit of the United States.

21. HUD’s direct endorsement program is one of the FHA-insured mortgage programs. A direct endorsement lender is authorized to underwrite mortgage loans, decide



whether the borrower represents an acceptable credit risk for HUD, and endorse loans for FHA mortgage insurance without prior HUD review or approval.

22. A direct endorsement lender is responsible for all aspects of the mortgage application, the property analysis, and the underwriting of the mortgage. The underwriter must “evaluate [each] mortgagor’s credit characteristics, adequacy and stability of income to meet the periodic payments under the mortgage and all other obligations, and the adequacy of the mortgagor’s available assets to close the transaction, and render an underwriting decision in accordance with applicable regulations, policies and procedures.” 24 C.F.R. § 203.5(d). To qualify for FHA mortgage insurance, a mortgage must meet all of the applicable HUD requirements.

23. After the mortgage has closed, the direct endorsement lender must certify that the lender conducted due diligence and/or ensured data integrity and that the endorsed mortgage complies with HUD rules and is “eligible for HUD mortgage insurance under the Direct Endorsement program.” HUD Form 92900-A. FHA then endorses the loan and provides the lender with a mortgage insurance certificate.

24. HUD relies on the expertise and knowledge of direct endorsement lenders in providing FHA insurance and places confidence in their decisions. A direct endorsement lender is therefore obligated to act with the utmost good faith, honesty, fairness, undivided loyalty, and fidelity in dealings with HUD. The duty of good faith also requires a direct endorsement lender to make full and fair disclosures to HUD of all material facts and to take on the affirmative duty of employing reasonable care to avoid misleading HUD in all circumstances.

25. To maintain HUD-FHA approval, a direct endorsement lender must implement and maintain a quality control program. HUD requires the quality control department to be independent of mortgage origination and servicing functions. *See* HUD Handbook, 4060.1 REV-2, paragraph 7-3(B).

26. As part of its quality control program, a lender must (among other things): (a) review 10% of all closed loan files to ensure they were underwritten in accordance with HUD guidelines; and (b) conduct a full review of *all* early payment defaults. HUD Handbook 4060.1, REV-1, Sec. 6-6(G)(1); HUD Handbook 4060.1, REV-2, Sec. 7-3(L).

27. In conducting a quality control review of a loan file, the lender must, among other things, review and confirm specific items of information. For instance, “[d]ocuments contained in the loan file should be checked for sufficiency and subjected to written re-verification. Examples of items that must be re-verified include, but are not limited to, the mortgagor’s employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds.” HUD Handbook 4060.1 REV-2, paragraph 7-6 (E)(2). Further, “[a]ny discrepancies must be explored to ensure that the original documents . . . were completed before being signed, were as represented, were not handled by interested third parties and that all corrections were proper and initialed.” *Id.*

28. Where the quality control review discovers “[f]indings of fraud or other serious violations,” the lender must immediately notify HUD of its findings. HUD Handbook, 4060.1 REV-2, paragraph 7-3(J). A lender’s quality control program “must ensure that [such] findings discovered by employees during the normal course of business and by quality control staff during reviews/audits of FHA loans are reported to HUD within 60 days of the initial discovery.”

*Id.*; see also HUD Handbook, 4060.1 REV-2, paragraph 2-23 (“Mortgagees are required to report to HUD any fraud, illegal acts, irregularities or unethical practices.”). Upon discovering fraud, the lender must also expand the scope of quality control review by increasing both the number of files reviewed and conducting a more in-depth review of the selected files.

29. Finally, quality control review findings must “be reported to the mortgagee’s senior management within one month of completion of the initial report” and “[m]anagement must take prompt action to deal appropriately with any material findings.” HUD Handbook 4060.1 REV-2, paragraph 7-3(I). Appropriate action by management includes following up with underwriters responsible for material findings to ensure that they are properly trained and diligently reviewing each file before endorsing it for FHA mortgage insurance.

#### **B. Citi’s Systematically Defective Quality Control Program**

30. Since 2004, when Citi first moved its quality control department “in-house” (it had previously been handled by an outside contractor), Citi has failed to maintain a quality control program that complied with HUD regulations, handbooks, and policies. Initially, Citi’s quality control department did not even attempt to perform the work required by HUD, while later on it attempted to perform the required work, but found its efforts thwarted by Citi’s business personnel. At no time did Citi’s quality control program perform its basic functions: improving the quality of Citi’s underwriting, mitigating HUD’s risk, and reporting HUD critical information about fraudulent or defective loans.

##### **1. The 2008 HUD Audit**

31. In 2008, HUD’s Office of Inspector General (“HUD-OIG”) audited Citi and found numerous defects in its quality control program. The audit concluded that Citi lacked

adequate internal controls to ensure that FHA loans met HUD underwriting requirements or to ensure that Citi's quality control program met HUD requirements.

32. Among other things, the HUD-OIG audit concluded that Citi had failed to comply with HUD's requirement that a quality control program fully review all early payment default loan files. In response to the audit, Citi admitted that its practice was to conduct only a partial review on many of the files. Not until at least late 2008 or 2009, after receiving the results of this audit, did Citi even attempt to review all early payment defaults.

33. Citi's quality control program also failed to meet HUD's guidelines governing which loan file elements needed to be evaluated during the quality control process, and failed consistently to follow the required process of re-verifying income and employment for the loans it did review

34. Citi did not contest HUD's findings.

## **2. Manipulation of Citi's Quality Control Reports by Citi's Business Units**

35. Following the 2008 HUD-OIG audit, Citi represented that it would bring its quality control program into compliance. Citi, however, failed to do so. Indeed, although it addressed a handful of specific defects identified by HUD during the audit, following the 2008 audit, Citi took steps to weaken its quality control program by undermining the independence of its quality control department and manipulating the results of its quality control reviews.

36. Citi established "gatekeeper" personnel in its business units who are given the job of pressuring quality control to downgrade its assessments of loan problems. This new practice, which violated HUD requirements, prompted an email dated August 6, 2009, from Michael

Watts, the director of quality control, to Scott McIlhaney, the director of operational risk, stating that the business channels “are beginning to really worry me with the frequent attempts to manipulate QC results.”

37. Citi also established an “escalation committee” (later referred to as an “appeal committee”) comprised of non-quality control employees – including business operations personnel – to act as final arbiter of whether a quality control finding or classification should be upheld, removed, or downgraded. Under pressure from the business channels, the escalation committee frequently sided with the gatekeepers in their challenges to quality control reports and directed quality control to remove or reduce the violations it was finding. As a result, when quality control acceded to these demands for changes, Citi’s quality control reports ceased to reflect quality control’s independent assessment of the loans, in violation of HUD requirements.

38. Throughout 2010, gatekeepers – encouraged by Citi’s management – continued to challenge otherwise indisputable quality control findings, simply to drive down the “variance” rates on loans. On May 21, 2010, Watts again emailed concerns about the gatekeepers’ conduct to McIlhaney as well as Jeffrey Polkinghorne, Citi’s director of “front-end risk.” Watts again alerted them that gatekeepers were continuing to pressure quality control to reverse their findings and warned that this pressure was “increasing in intensity.” Watts added that the gatekeepers:

are getting more than a reasonable amount of pressure to dispute QC findings that are clearly not disputable . . . The gatekeepers are being pressured to prepare reporting on the number of rebuttals and the percent of those that are successful—essentially a performance goal or measurement of success rate on the rebuttals. Instead of reviewing and analyzing results and then teaching their channels what is needed to improve, they’re being encouraged to rebut legitimate variances in an effort to drive down the rate. It appears that is how their worth is being measured.

Watts warned that this practice is “sustainable only until such time as an outside authority discovers and reports the real variance rate,” and that “[l]eadership must demand a focus on the root causes of the defects . . .”

39. Notwithstanding Watts’s pleas, Citi took no action to address this problem, and the intrusion of business interests into quality control only grew worse. In July of 2010, a business channel manager informed Watts that quality control should reduce its reports to upper management to “tier 1 only” – that is, only to a portion of the loans in which quality control was finding material variances. Around the same time, Citi based the compensation of its business operations employees on their “tier 1 variance rates,” rewarding employees with higher salaries for lower variance rates. According to Watts, this compensation structure prompted “the ferocity of demands from Operations to have tier 1 variances downgraded to lower tiers.”

40. By November of 2010, the business channels had set a goal of reducing their Tier 1 defect rate to 5%. Thereafter, a business channel manager informed the quality control managers, “Our marching orders are to fight tiering on everything we get from QC.” That same month, Ross Leckie, senior director of Citi’s retail bank mortgage operations, provided comments on quality control variance findings, stating: “please take [these] in the spirit they are offered, which is to drive this [variance] rate down by brute force. . .” Leckie further observed, “[w]e currently have 10 loans with Tier 1 defects out of 138 or 7.25% . . . We need [] 3 loans to be removed to get to 5.07%.”

41. In response to these messages, Watts again emailed McIlhaney, expressing concern about the business unit’s “marching orders . . . to fight QC for all tiers to drive their defect rates down.” Watts further stated that “[a]dmittedly even when they agree with the defect

they are going to continue to fight the tiers. This is nothing short of abuse and borders on fraudulent actions, and staff has expressed serious concerns.” Watts separately emailed another employee that “this continuing effort to reduce tier 1 reported variances in this manner has the potential to overstate the quality of the loans.”

42. Far from heeding Watts’s warnings, Citi blamed the quality control employees for finding material variances in Citi’s loans and rewarded business personnel for fighting quality control. In January of 2011, Citi held a quarterly “Star Players Award” ceremony, in which a business operations unit team was given an award for its efforts to “drive variance rates down by challenging Quality Control to remove or reduce variances.” Watts complained to Polkinghorne and McIlhaney that “[w]hen something like this is celebrated at the leadership level it can be quite demoralizing[,] making it appear like a lack of support from the leadership team for the QC work effort.”

43. On June 15, 2011, following a meeting of the appeal committee, Watts complained that “no one from the [Business] Channels questioned the validity of the defects reported. They frequently acknowledge the defects were accurate as reported. This meeting was exclusive to debating the tier 1 classification sufficiently to wear down the committee members so they would reduce the tier 1 to something that would not negatively impact their incentive plans.” In response, Hunt, the quality control manager focusing on FHA loans, wrote that “We also have Polkinghorne telling us it is our asses (QC) [] on the line] if the quality does not improve.”

### **3. Citi Fails to Report Fraudulent Loans**

44. In addition to attacking the findings of its quality control department, for years Citi failed to report the most serious findings—those of fraud or other serious violations—from HUD and other third parties. Indeed, Citi failed even to review hundreds of potentially fraudulent loan files and simply cleared the fraud referrals from its database from its review database.

45. As an initial matter, Citi has never permitted its quality control department to refer findings of fraud or other material violations directly to HUD, instead channeling those communications through Citi’s “repurchasing unit” – referred to as “Repurchase” – a business unit not otherwise involved in quality control. Even if quality control finds evidence of fraud in the loan file, it must send the loan to Citi’s “fraud prevention & investigation unit” (“FPI” or “fraud unit”), which, assuming the fraud is confirmed, must then send the loan to the repurchasing unit for reporting to HUD or another third party.

46. Both the fraud unit and the repurchasing unit served as little more than holding areas for the loans that the quality control department believed to be fraudulent or have other serious defects. Beginning in 2005, Repurchase failed to report a single loan that was originated or underwritten by Citi to HUD, until July 2011, after Citi had received a subpoena from the United States Attorney’s Office concerning the facts giving rise to this lawsuit.

47. Although Citi did report more than 200 loans to HUD during that five-year period, all of the loans were “correspondent” loans, *i.e.*, loans that Citi purchased from other loan originators, but did not itself underwrite. Citi was free to report such loans to HUD without risk to Citi’s business operations, because the lender that underwrote the loan would be liable for



indemnifying HUD for any losses incurred, rather than Citi. No loans originated or underwritten by Citi, for which Citi was on the hook, were reported.

48. In March of 2008, in the course of an audit, HUD's Office of Inspector General called to Citi's attention the fact that Citi had not reported any fraudulent or defective loans that Citi itself had underwritten. On April 2, 2008, senior compliance officer Don Houghtalin emailed Karen Smugala, a quality control manager, noting that the "HUD auditor is questioning why we have not self reported any loans that were underwritten by CMI [CitiMortgage]." Smugala confirmed that all referrals went to the fraud unit or to the repurchase unit, but added that "repurchase has told us on several occasions not to send a lot of stuff . . . so I don't know how much of it actually gets self-reported."

49. One problem with Citi's self-reporting system was a persistent backlog of referrals from the quality control department to the fraud unit. Although Citi's fraud unit agreed with quality control's conclusions in approximately 50% of the referrals it actually reviewed, by December of 2009, the fraud unit had accumulated a backlog of nearly 1,000 referrals that it had not even looked at. More than 80% of these loans were early payment defaults, which are markers of mortgage fraud. These 1,000 referrals included FHA loans originated by third parties, non-FHA loans, and Citi-originated or underwritten FHA loans.

50. By email dated December 7, 2009, Hunt sent Smugala the full list of "FPI Outstanding Referrals," noting that the early payment defaults (just one subset of the referrals) that remained outstanding totaled "875 loans with 479 at 180 days past due." On April 8, 2010, when quality control manager Suzanne Starks attempted to follow up on old files referred to the fraud unit, she was informed by a fraud unit employee that "a response did not need to be sent on

QC referrals,” adding that “[m]y manager . . . had worked that out with Mike Watts.” Starks at that point raised the issue with Watts, stating, “We have all these loans without responses, and frankly if we get audited on one of these we have no response back to a potential fraud issue and we did not refer it or do anything.”

51. Unable to process the massive backlog of potentially fraudulent loans, Citi instead erased – without any self-reporting – the nearly 1,000 fraudulent loan referrals it had accumulated but never investigated between 2006 and the end of 2009.

52. Even after clearing its backlog (without conducting review), Citi could not keep up with its fraud referrals. By April 2010, the fraud unit had already accumulated 135 new referrals that it had not yet investigated. And by April of 2011, the fraud unit had built up a new backlog of 400 referrals just since December 2009 that had not yet been investigated and resolved. When Hunt raised this issue with Watts, he informed her that she could clear those referrals from the review process because they were too old to investigate anyway.

53. As stated above, even when a loan was investigated by the fraud unit and confirmed to be fraudulent, it still had to pass through a second unit, Repurchase, which was responsible for self-reporting to HUD or other appropriate third parties, but in fact rarely did. For example, in August of 2010, Hunt commented to Watts that “there are so few loans being self-reported that I am not sure the process still exists,” and was informed that the self-reporting process was “transferred back to the [business] channels.” A few months later, when Hunt asked a business channel manager about such reporting, she responded that she was “not aware of any ‘self-reporting’ component.”

54. Some of the loans that Citi failed to report include loans that defaulted when their first payment was due and had other indicators of mortgage fraud.

55. For instance, FHA case number 137-5863414 was a loan originated in 2010 for \$114,000. The loan was underwritten by Citi and resulted in a first payment default. Quality control reviewed the loan and referred it to the fraud unit, which confirmed fabricated bank statements in the loan file and the existence of a straw buyer. Nevertheless, Citi failed to report the loan to HUD.

56. FHA case number 361-3563920 was a loan originated in 2010 for \$136,000 and underwritten by Citi. Quality control reviewed the loan and referred it to the fraud unit, which confirmed altered bank statements and other misrepresentations in the loan file. Nevertheless, Citi failed to report the loan to HUD.

57. FHA case number 371-4443216 was a loan originated in 2010 for \$206,000 and underwritten by Citi. Quality control reviewed the loan and referred it to the fraud unit, which confirmed fraudulent concealment by the borrower of an additional home purchase using a Freddie Mac Mortgage. Nevertheless, Citi failed to report the loan to HUD.

58. In total, from 2005 to the present, Citi has reported to HUD on only *four* fraudulent loans that it originated or underwrote, and all four of those were reported in July of 2011 or later, after Citi received a subpoena from the United States Attorney's Office. Citi's systematic failure to investigate fraudulent loans, its concealment of its failure to investigate through expunging records, and its failure to report on the loans that were confirmed to contain fraud or other serious violations, all served to keep its reckless lending practices hidden from HUD and the public.

**C. Citi's Lack of Quality Control Led to Widespread Underwriting Violations**

59. Citi's lack of quality control, set forth in detail above, led to nationwide deficiencies in Citi's underwriting.

60. Between 2004 and present, Citi approved nearly 30,000 mortgages for FHA insurance and for each mortgage, and in each case Citi certified that the mortgage was eligible for FHA insurance and that the underwriter complied with applicable HUD rules on data integrity and due diligence. Contrary to its certifications, however, Citi engaged in a pattern of failing to conduct due diligence in accordance with HUD rules and with sound and prudent underwriting principles.

61. Citi's systematic problems were identified in a 2008 audit of loans closed in 2006 and 2007, in which auditors from HUD-OIG found material underwriting deficiencies in one-third of the defaulted loans they reviewed. HUD-OIG found, among other things, that Citi did not properly assess the credit history and liabilities of borrowers, did not properly evaluate the assets used to qualify for loans, and did not properly evaluate borrower income. Overall, HUD-OIG found not only that Citi's quality control program failed to meet HUD requirements, but also that Citi did not have adequate controls in place to ensure that FHA loans met HUD underwriting requirements.

62. In its response to the HUD-OIG audit, Citi "agree[d] that the number and type of errors found in the sample loans are unacceptable" and represented that it would remedy its underwriting deficiencies.

63. Notwithstanding this acknowledgement of improper lending practices, the misconduct continued.

64. The examples set forth below represent a small sample of the total number of mortgages for which Citi submitted false certifications.

### **1. The Sheltered Harbor Drive Property in Colorado**

65. FHA case number 052-4075640 relates to a property on Sheltered Harbor Drive in Evans, Colorado (the “Sheltered Harbor Drive Property”). Citi underwrote the mortgage for the Sheltered Harbor Drive Property, reviewed and approved it for FHA insurance, and certified that the mortgage qualified for FHA insurance. The mortgage closed on or about April 25, 2007.

66. Contrary to Citi’s certification, Citi did not comply with HUD rules in reviewing and approving this loan for FHA insurance. Instead, Citi violated multiple HUD rules, including HUD Handbook 4155.1 ¶ 1-12.

67. HUD underwriting guidelines state that delinquent mortgages are not eligible for streamline refinancing until the loan is brought current. HUD Handbook 4155.1 ¶ 1-12. Contrary to this eligibility requirement, Citi approved and closed the loan even though the file indicated the mortgage being refinanced was delinquent.

68. Citi’s false certification on this loan was material and bore upon the loan’s eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

69. Within three months after closing, the Sheltered Harbor Drive Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$166,259, including costs.

### **2. The East 26th Way Property in Colorado**

70. FHA case number 052-4153675 relates to a property on East 26th Way in Aurora, Colorado (the “East 26th Way Property”). Citi, using an FHA approved automated underwriting

system (“AUS”), underwrote the mortgage for the East 26th Way Property, reviewed and approved it for FHA insurance, and certified to the integrity of the data supplied and that the mortgage qualified for FHA insurance. The mortgage closed on or about September 21, 2007.

71. Because the soundness of the AUS’s evaluation is dependent on the accuracy and reliability of the data submitted by the mortgagee, a mortgagee may only enter into the AUS such income, assets, debts, and credit information that meets FHA’s applicable eligibility rules and documentation requirements, including those set forth in HUD Handbook 4155.1, Mortgagee Letters, the FHA TOTAL Mortgage Scorecard User Guide, and the AUS certificate.

72. Contrary to Citi’s certification, the data Citi entered into the AUS lacked integrity or was unverified, and the mortgage loan failed to meet FHA’s eligibility rules and documentation requirements.

73. Despite clear requirements, Citi failed to obtain the required documentation to verify the borrower’s income and depository assets. In failing to accurately and reliably verify information submitted into AUS, Citi submitted a loan for FHA-endorsement that was ineligible for FHA insurance, and was supported by data lacking integrity.

74. Citi’s false certification on this loan was material and bore upon the loan’s eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

75. Within two months after closing, the East 26th Way Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$142,458, including costs.

### **3. The Old Chattanooga Valley Road Property in Georgia**

76. FHA case number 105-4061254 relates to a property on Old Chattanooga Valley Road in Flintstone, Georgia (the “Old Chattanooga Valley Road Property”). Citi, using an FHA approved AUS, underwrote the mortgage for the Old Chattanooga Valley Road Property, reviewed and approved it for FHA insurance, and certified to the integrity of the data supplied and that the mortgage qualified for FHA insurance. The mortgage closed on or about September 25, 2008.

77. Because the soundness of the AUS’s evaluation is dependent on the accuracy and reliability of the data submitted by the mortgagee, a mortgagee may only enter into the AUS such income, assets, debts, and credit information that meets FHA’s applicable eligibility rules and documentation requirements, including those set forth in HUD Handbook 4155.1, Mortgagee Letters, the FHA TOTAL Mortgage Scorecard User Guide, and the AUS certificate.

78. Contrary to Citi’s certification, the data Citi entered into the AUS lacked integrity and the mortgage loan failed to meet FHA’s eligibility rules and documentation requirements.

79. Despite clear requirements, Citi failed to obtain the required documents to verify the borrower’s employment, income, and receipt of gift funds. In failing to accurately and reliably verify information submitted into AUS, Citi submitted a loan for FHA-endorsement that was ineligible for FHA insurance, and was supported by data lacking integrity.

80. Citi’s false certification on this loan was material and bore upon the loan’s eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

81. Within two months after closing, the Old Chattanooga Valley Road Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$137,376, including costs.

#### **4. The Dave Drive Property in Ohio**

82. FHA case number 412-5576687 relates to a property on Dave Drive in Madison, Ohio (the “Dave Drive Property”). Citi, using an FHA approved AUS, underwrote the mortgage for the Dave Drive Property, reviewed and approved it for FHA insurance, and certified to the integrity of the data supplied and that the mortgage qualified for FHA insurance. The mortgage closed on or about October 15, 2007.

83. Because the soundness of the AUS’s evaluation is dependent on the accuracy and reliability of the data submitted by the mortgagee, a mortgagee may only enter into the AUS such income, assets, debts, and credit information that meets FHA’s applicable eligibility rules and documentation requirements, including those set forth in HUD Handbook 4155.1, Mortgagee Letters, the FHA TOTAL Mortgage Scorecard User Guide, and the AUS certificate.

84. Contrary to Citi’s certification, the data Citi entered into the AUS lacked integrity and the mortgage loan failed to meet FHA’s eligibility rules and documentation requirements.

85. Despite clear requirements, Citi failed to obtain the required documentation to verify the borrower’s income and assets. Additionally, Citi misrepresented the borrower’s eligibility for the amount of insurance for which the loan was submitted. In failing to accurately and reliably verify information submitted into AUS, Citi submitted a loan for FHA-endorsement that was ineligible for FHA insurance, and was supported by data lacking integrity.



86. Citi's false certification on this loan was material and bore upon the loan's eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

87. Within two months after closing, the Dave Drive Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$123,609, including costs.

## **5. The Median Circle Property in Virginia**

88. FHA case number 541-7646512 relates to a property on Median Circle in Portsmouth, Virginia (the "Median Circle Property"). Citi underwrote the mortgage for the Median Circle Property, reviewed and approved it for FHA insurance, and certified that Citi had conducted due diligence on the mortgage application. The mortgage closed on or about October 24, 2007.

89. Contrary to Citi's certification, Citi did not comply with HUD rules in reviewing and approving this loan for FHA insurance. Instead, Citi violated multiple rules, including HUD 4155.1, REV-5, Chs. 2 and 3, and HUD Mortgagee Letters 1999-26 and 2001-01.

90. HUD underwriting guidelines require that all sources of borrower income be documented per HUD requirements. Additionally, HUD underwriting guidelines require Direct Endorsement lenders to ensure verification forms and documents not pass through the hands of third parties. Contrary to these guidelines, Citi approved and closed the loan based on the income that was not verified per HUD requirements and verification forms and documents that appeared to pass through the hands of a third party.

91. Citi's false certification on this loan was material and bore upon the loan's eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

92. Within two months after closing, the Median Circle Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$135,418, including costs.

## **6. The Park Street Property in Florida**

93. FHA case number 093-5922175 relates to a property on Park Street in Eaton Park, Florida (the "Park Street Property"). Citi underwrote the mortgage for the Park Street Property, reviewed and approved it for FHA insurance, and certified that Citi had conducted due diligence on the mortgage application. The mortgage closed on or about May 20, 2005.

94. Contrary to Citi's certification, Citi did not comply with HUD rules in reviewing and approving this loan for FHA insurance. Instead, Citi violated multiple rules, including HUD 4155.1, REV-5, Chs. 2 and 3, HUD Handbook 400.4, REV-2, Ch. 2, and HUD Mortgagee Letter 1992-05.

95. HUD underwriting guidelines require Direct Endorsement lenders to verify the borrower's employment and obtain copies of the borrower's most recent pay stubs. HUD Handbook 4155.1, Ch. 3. Contrary to these guidelines, Citi failed to obtain the required documentation necessary to verify the borrower's employment and income.

96. Citi's false certification on this loan was material and bore upon the loan's eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

97. Within three months after closing, the Park Street Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$119,068, including costs.

## **7. The Harris Street Property in Georgia**

98. FHA case number 105-3069575 relates to a property on Harris Street in McDonough, Georgia (the “Harris Street Property”). Citi underwrote the mortgage for the Harris Street Property, reviewed and approved it for FHA insurance, and certified that Citi had conducted due diligence on the mortgage application. The mortgage closed on or about June 14, 2007.

99. Contrary to Citi’s certification, Citi did not comply with HUD rules in reviewing and approving this loan for FHA insurance. Instead, Citi violated multiple rules, including HUD Handbook 4150.2, HUD Handbook 4000.4, Ch. 2, HUD Handbook 4155.1, Ch. 3, and Mortgagee Letters 1999-26 and 1992-5.

100. HUD underwriting guidelines require that Direct Endorsement lenders carefully review the appraisal supporting the mortgage loan. Additionally, lenders must resolve conflicting information appearing in the loan file. Contrary to these guidelines, Citi approved and closed the loan without adequately reviewing the appraisal and without resolving conflicting information appearing in the loan file.

101. Citi’s false certification on this loan was material and bore upon the loan’s eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

102. Within three months after closing, the Harris Street Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$171,425, including costs.

## **8. The Peggy Drive Property in Kentucky**

103. FHA case number 201-3457852 relates to a property on Peggy Drive in Henderson, Kentucky (the “Peggy Drive Property”). Citi underwrote the mortgage for the Peggy Drive Property, reviewed and approved it for FHA insurance, and certified that Citi had conducted due diligence on the mortgage application. The mortgage closed on or about March 25, 2005.

104. Contrary to Citi’s certification, Citi did not comply with HUD rules in reviewing and approving this loan for FHA insurance. Instead, Citi violated multiple rules, including HUD Handbook 4155.1 ¶ 1-12(D).

105. HUD underwriting guidelines state that delinquent mortgages are not eligible for streamline refinancing until the loan is brought current. HUD Handbook 4155.1 ¶ 1-12. Contrary to this eligibility requirement, Citi approved and closed the loan even though the file indicated the mortgage being refinanced was delinquent.

106. Citi’s false certification on this loan was material and bore upon the loan’s eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

107. Within three months after closing, the Peggy Drive Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$79,515, including costs.

## **9. The Millennium View Drive Property in Georgia**

108. FHA case number 105-2827824 relates to a property on Millennium View Drive in Snellview, Georgia (the “Millennium View Drive Property”). Citi underwrote the mortgage for the Millennium View Drive Property, reviewed and approved it for FHA insurance, and

certified that Citi had conducted due diligence on the mortgage application. The mortgage closed on or about December 13, 2006.

109. Contrary to Citi's certification, Citi did not comply with HUD rules in reviewing and approving this loan for FHA insurance. Instead, Citi violated multiple rules, including HUD Handbook 4155.1 ¶ 1-12.

110. HUD underwriting guidelines state that delinquent mortgages are not eligible for streamline refinancing until the loan is brought current. HUD Handbook 4155.1 ¶ 1-12. Contrary to this eligibility requirement, Citi approved and closed the loan even though the file indicated the mortgage being refinanced was delinquent.

111. Citi's false certification on this loan was material and bore upon the loan's eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

112. Within two months after closing, the Millennium View Drive Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$131,032, including costs.

## **10. The Champion Drive Property in Texas**

113. FHA case number 495-7597076 relates to a property on Champion Drive in Round Rock, Colorado (the "Champion Drive Property"). Citi underwrote the mortgage for the Champion Drive Property, reviewed and approved it for FHA insurance, and certified that Citi had conducted due diligence on the mortgage application. The mortgage closed on or about February 21, 2007.

114. Contrary to Citi's certification, Citi did not comply with HUD rules in reviewing and approving this loan for FHA insurance. Instead, Citi violated multiple rules, including HUD Handbook 4155.1 ¶ 1-12.

115. HUD underwriting guidelines state that delinquent mortgages are not eligible for streamline refinancing until the loan is brought current. HUD Handbook 4155.1 ¶ 1-12. Contrary to this eligibility requirement, Citi approved and closed the loan even though the file indicated the mortgage being refinanced was delinquent.

116. Citi's false certification on this loan was material and bore upon the loan's eligibility for FHA insurance and the likelihood that the borrower would make mortgage payments.

117. Within two months after closing, the Champion Drive Property mortgage went into default. As a result, HUD paid an FHA insurance claim of \$168,665, including costs.

**D. Citi's False Certifications Have Resulted in Losses to HUD**

118. HUD has paid FHA insurance claims relating to mortgages insured by FHA based on Citi's false certifications of due diligence and eligibility, similar to the examples set forth in the previous section of this Complaint. HUD would not have made a financial commitment to pay such mortgage insurance claims absent Citi's false certifications.

119. Citi's false certifications, similar to the examples set forth in the previous section of this Complaint, were material and bore upon the likelihood that borrowers would make mortgage payments.

120. As of December 2011, HUD has paid approximately \$198 million in FHA insurance claims and related costs arising out of Citi's approval of mortgages for FHA insurance.

A substantial percentage of those claims resulted from loans that were ineligible for FHA insurance and never should have been insured.

121. HUD expects to pay millions of dollars in additional FHA insurance claims as additional mortgages underwritten by Citi default in the months and years ahead.

122. The costs relating to FHA insurance claims paid by HUD to date and the costs relating to FHA insurance claims expected to be paid by HUD are the direct result of Citi's false certifications and representations described above.

### **FIRST CLAIM**

#### **Violations of the False Claims Act (31 U.S.C. § 3729(a)(1) (2006), and as amended, 31 U.S.C. § 3729(a)(1)(A)) Causing False Claims**

123. The Government incorporates by reference each of the preceding paragraphs as if fully set forth in this paragraph.

124. The Governments seeks relief against Citi against Section 3729(a)(1) of the False Claims Act, 31 U.S.C. § 3729(a)(1) (2006), and, as amended, Section 3729(a)(1)(A) of the False Claims Act, 31 U.S.C. § 3729(a)(1)(A).

125. As set forth above, Citi knowingly, or acting with deliberate ignorance and/or with reckless disregard for the truth, presented and/or caused to be presented, to an officer or employee of the Government, false and fraudulent claims for payment or approval in connection with its endorsement of FHA-insured mortgages, by submitting false loan-level certifications to HUD in endorsing mortgages for FHA insurance.

126. HUD paid insurance claims, and incurred losses, relating to FHA-insured mortgages wrongfully endorsed by Citi's wrongful conduct.

127. By reason of the false claims of Citi, the Government has been damaged in a substantial amount to be determined at trial, and is entitled to treble damages and a civil penalty as required by law for each violation.

## **SECOND CLAIM**

### **Violations of the False Claims Act (31 U.S.C. § 3729(a)(1)(B)) Use of False Statements**

128. The Government incorporates by reference each of the preceding paragraphs as if fully set forth in this paragraph.

129. The Government seeks relief against Citi under Section 3729(a)(1)(B) of the False Claims Act, 31 U.S.C. § 3729(a)(1)(B), or, in the alternative, under Section 3729(a)(2) of the False Claims Act, 31 U.S.C. § 3729(a)(1) (2006).

130. As set forth above, Citi knowingly, or acting in deliberate ignorance and/or with reckless disregard of the truth, made, used, or caused to be made or used, false records and/or statements material to false or fraudulent claims in connection with Citi's loan-by-loan endorsement of mortgages.

131. HUD paid insurance claims, and incurred losses, relating to FHA-insured mortgages wrongfully endorsed by Citi because of its wrongful conduct.

132. By reason of the false records and/or statements of Citi, the Government has been damaged in a substantial amount to be determined at trial, and is entitled to treble damages and a civil penalty as required by law for each violation.



### **THIRD CLAIM**

#### **Violations of FIRREA (12 U.S.C. § 1833a) False Certifications to HUD**

133. The Government incorporates by reference each of the preceding paragraphs as if fully set forth in this paragraph.

134. By virtue of the acts described above, and for the purpose of inducing HUD to endorse loans for FHA insurance, Citi knowingly made, used, or caused to be made or used, false certifications stating that loans were eligible for FHA insurance and that Citi complied with other requirements including maintenance of data integrity and/or due diligence. Citi submitted such false certifications to HUD in violation of 18 U.S.C. §§ 1006 and 1014.

135. Citi (a) made statements to HUD with the intent to defraud or deceive HUD into endorsing loans that were ineligible for FHA insurance (18 U.S.C. § 1006); and (b) knowingly made false statements for the purpose of influencing the FHA (18 U.S.C. § 1014, as amended).

136. Accordingly, for the false certifications submitted to HUD between 2004 and 2011, Citi is liable to HUD for civil penalties as authorized under 12 U.S.C. § 1833a, in the amount of up to the greater of (i) \$1 million per violation, (ii) the amount of loss to the United States, or (iii) the amount of gain to Citi.

### **FOURTH CLAIM**

#### **Breach of Fiduciary Duty**

137. The Government incorporates by reference each of the preceding paragraphs as if fully set forth in this paragraph.

138. HUD and Citi have a special relationship of trust and confidence by virtue of Citi's participation in the direct endorsement lender program. The direct endorsement lender program empowered Citi to obligate HUD to insure mortgages it issued without any independent HUD review. Citi is therefore in a position of advantage or superiority in relation to HUD and is a fiduciary to HUD.

139. As a fiduciary, Citi had a duty to act for, and give advice to, the Government for the benefit of the Government as to whether mortgages should be insured by FHA under the direct endorsement lender program.

140. As a fiduciary, Citi had an obligation to act in the utmost good faith, candor, honesty, integrity, fairness, undivided loyalty, and fidelity in its dealings with the Government.

141. As a fiduciary, Citi had a duty to exercise sound judgment, prudence, and due diligence on behalf of HUD in endorsing mortgages for FHA insurance.

142. As a fiduciary, Citi had a duty to refrain from taking advantage of HUD by the slightest misrepresentation, to make full and fair disclosures to HUD of all material facts, and to take on the affirmative duty of employing reasonable care to avoid misleading the Government in all circumstances.

143. As set forth above, Citi breached its fiduciary duty to HUD by submitting false certifications.

144. As a result of Citi's breach of the fiduciary duty, HUD has paid insurance claims and incurred losses, and will pay additional insurance claims in the future insurance claims and incur future losses, relating to FHA-insured mortgages endorsed by Citi.

145. By virtue of the above, the Government is entitled to compensatory damages for these past and future losses, in an amount to be determined at trial.

WHEREFORE, the Government respectfully requests that judgment be entered in its favor and against Citi as follows:

- a. On Counts One and Two (False Claims Act), judgment for the Government, treble the Government's damages, and civil penalties for the maximum amount allowed by law;
- b. On Count Three (FIRREA), judgment for the Government and civil penalties up to the maximum amount authorized under 12 U.S.C. § 1833a;
- c. On Count Four (Breach of Fiduciary Duty), judgment for the Government against Citi and compensatory damages making the Government whole for past and future losses;
- d. For an award of costs pursuant to 31 U.S.C. § 3729(a); and
- e. For an award of any such further relief as is proper.

Dated: New York, New York  
February 14, 2012

PREET BHARARA  
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